

Improving the Collection of Social Insurance Contributions in Mongolia

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PREFACE

This is a report of a technical assistance mission to Mongolia during the period November 1 through November 26, 1999. The purpose of the mission was to provide assistance to the State Social Insurance General Office (SSIGO) to improve collections of social insurance contributions, as part of the overall project to reform the pension system.

The two main tasks for the mission were to (a) evaluate current procedures for collecting contribution declarations and payments from employers (as payers of mandatory contributions on behalf of their employees), and (b) make recommendations to improve compliance by strengthening the collection and enforcement processes.

It became clear early on in the mission that the SSIGO had a reasonable system in place to process employer declarations and payments, update contributors' accounts, and identify underpayments. Therefore, the areas where most attention was given were to:

- Broaden the base of social insurance contribution payers by identifying unregistered employers;
- Reduce the level of social insurance contribution debts by strengthening collection enforcement procedures;
- Detect under-reported income by better targeting of audit resources and strengthening auditing methods.

Discussions were held with Mr. Sukhbaatar, Chairman of SSIGO, Mr. Sumaakhuu, Deputy Chairman SSIGO and Chairman of Ulaanbaatar City Office, and many other SSIGO officials. Visits were made to SSIGO offices in Chingeltei District, Songino-khairkhan District, Baganuur District, Tov Aimag, and Erdyn Soum. Some discussions were also held with tax officials from the General Department of National Taxation, and with the Revenue Policy Division in the Ministry of Finance.

Two training courses were conducted for Ulaanbaatar City SSIGO managers and inspectors. About 30 people attended the course on Collection Enforcement. The course on Auditing Employers was attended by 20 auditors from the city offices and SSIGO headquarters.

BACKGROUND

The Government of Mongolia is undertaking a major reform of the pension system, with a phased transition from a pay-as-you-go system to a partially funded system based on individual notional defined contribution accounts. At present, compulsory contributions are required from all employees for pensions, benefits, workers compensation, unemployment and health insurance, and self-employed persons are encouraged to participate voluntarily.

The combined rate of contributions is (generally) 29% of insurable earnings (effectively gross salary), of which 10% is deducted from the employee's salary and 19% is contributed by the employer. Employers are also required to withhold personal income tax from employment income at marginal tax rates of 10%, 20% and 40% on taxable income, after taking into account various deductions (including social insurance contributions) and exemptions, and an annual tax credit (rebate) of 36,000 tg. In effect, employees start paying tax at 10% on monthly taxable incomes above 30,000 tg., and an employee with an average gross monthly income (per household - mid 1999) of 70,400 tg. would pay about 7,900 tg. income tax per month, or 11.3% of gross monthly income.

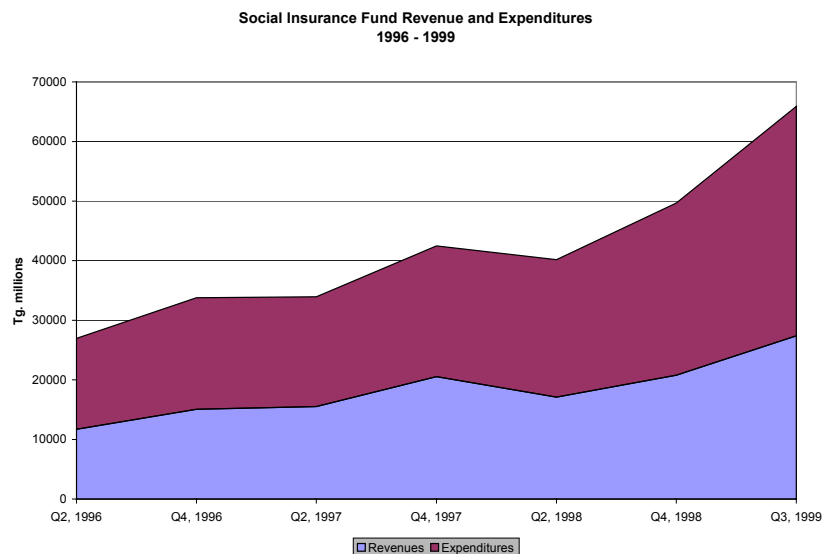
OBJECTIVES AND FUNCTIONS OF THE SOCIAL INSURANCE DEPARTMENT

The SSIGO has to achieve a number of competing objectives with limited resources.

- Pay pensions and benefits
- Establish new pension system
- Update individual accounts
- Collect contributions
- Enforce payment of debts
- Audit employers

At the time of this mission, the SSIGO was engaged in a major effort to establish opening account balances for all contributors born after January 1, 1960, as well as recalculating existing pensions and benefits, and conducting public education campaigns about the new pension scheme. Therefore, the first three objectives (paying pensions and benefits, introducing the new pension system, and establishing and updating contributors accounts) are consuming most of the SSIGO's resources, leaving reduced capacity to manage the collection and enforcement sides of the business.

At end September 1999, the SSIGO had collected 27,395 million tg., representing 86% of target revenue. Debts owed to the SSIGO by employers have increased by 30% from 8,900 million tg. at the beginning of the year to 11,695 million tg. at the end of September 1999. In all offices visited, the processing of declaration forms from employers seemed to be up to date, but in the city offices, only 75% of employers had filed all their declarations. The result is that the gap between annual expenditure and revenue is growing.



Understandably, most inspectors are working at the moment on recalculating pensions and calculating opening balances. The normal arrangement in the District and Aimag Offices is that there are about 6 contribution inspectors and 2 control inspectors, but the distinction between the work that they are doing is not clear.

Each contribution inspector has her own group of employers, and is responsible for collecting, checking and processing the declaration forms from these employers. If an employer does not file a declaration form, or does not pay the correct amount of contributions, it is the contribution inspector's job to contact the employer and collect the missing forms or money. In theory, the control inspectors are responsible for auditing the employers, but in practice the contribution inspectors also do this job, and the control inspectors also do debt collection work.

This sort of arrangement was appropriate when there were smaller numbers of employers, who were reasonably compliant because they were Government organizations or State owned enterprises. But as the number of private employers increases, specialist debt collection officers and auditors are needed if these activities are to be really effective in reducing the debts and controlling evasion.

MEASURING EFFICIENCY AND EFFECTIVENESS

The efficiency and effectiveness of the Social Insurance Office can be expressed by the following ratios:

$\text{Efficiency} = \frac{\text{Cost of administering pensions and benefits} + \text{Cost of collecting contributions}}{\text{Contributions collected}}$

This ratio measures the efficiency of the administration by a value-for money or business profit approach. For the SSIGO, the Government has set a maximum efficiency ratio of 2% of total collections. For tax administrations, the efficiency measure is the cost of collecting the revenue

divided by the total revenue collected. In these cases, a payroll and normal administration expenses cost of less than 1% of total revenue is generally regarded as efficient.

Effectiveness =	$\frac{\text{Pensions paid}}{\text{Pension entitlements legally payable}} \times \frac{\text{Contributions collected}}{\text{Contributions legally payable}}$
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The second ratio measures how effective the SSIGO is in paying the right amount of pensions and benefits, and collecting the contributions that should be paid according to the law. A true measure of effectiveness would also consider the timing factor – whether pensions were paid on time, and collections were received by the due dates. No measures are available for this ratio, but indicators and anecdotal evidence suggests that the gap is fairly wide.

The second part of the above effectiveness ratio can be broken down further into the following components. Each component measures a different part of the collection process, and helps identify which part of the collection process is causing problems. The effectiveness of collections can be improved by maximizing the following ratios:

<u>Number of registered employers</u> Actual number of employers	This is a measure of the effectiveness in detecting unregistered employers who are not in the system
<u>Number of registered contributors</u> Individuals in the workforce	This is the degree of compulsory and voluntary participation of the workforce in the pension system
<u>Number of declarations filed</u> Number of declarations due	This measures the extent of the non-filers – those employers who are in the system and who should file declarations, but have not done so
<u>Contributions paid</u> Contributions declared	This is the debt collection problem. The difference between contributions paid and declared is the level of tax arrears
<u>Contributions declared</u> Contributions payable	This measures the level of evasion and the effectiveness of the audit activity

REGISTRATION OF EMPLOYERS AND SELF-EMPLOYED PERSONS

Enterprises and self-employed persons need to register with the Tax Department before commencing business, before opening a bank account, and before registering with the SSIGO as an employer. The business registration unit in the State Department of National Taxation in Ulaanbaatar registers companies, cooperatives and partnerships and gives each taxpayer an unique 7-digit Taxpayer Register Number (TRN). The last digit of the TRN is a control digit based on a mathematical formula containing the first six digits, and this guards against entering incorrect numbers and, to some extent, using fictitious numbers. (This method is widely used to validate numbers – most credit card numbers, bank account numbers, passport numbers, etc. include a control digit).

Self-employed persons must also apply to the Tax Department for registration before commencing business. Up to about two years ago, self-employed persons were also given a TRN, but now they just use their Citizen's Register Number as their registration number. This is

the number every citizen is given at registration of birth. Enterprises must show their TRN to the bank before opening a new bank account, and they are supposed to display their Taxpayer Registration Certificate at their business premises.

The SSIGO also registers employers and voluntary contributors (self-employed individuals) and gives them a Certificate of Registration as a social insurance payer. The 6-digit Certificate Number (without a control digit) is used as their registration number. However, there is no connection between this Certificate Number and the TRN. The SSIGO receives regular printouts of new businesses registered with the Tax Department so that they can follow up new businesses that do not come to the SSIGO to get registered. Apparently, the SSIGO gets these printouts from the National Statistical Office, which receives the data originally from the Tax Department.

When new businesses apply to the Tax Department for registration, they have to provide information about the ownership of the business and what type of business activities they will be involved in. The information is entered into the Tax Department's computer system. In particular, the Tax Department gives each enterprise up to three ISIC¹ codes that describe the type of business activities the enterprise intends to do. This information would be valuable for the SSIGO to analyze payment trends by industry, to select enterprises for audit, and to target certain businesses for public education purposes.

The Tax Department also removes enterprises from the Taxpayer Register if they cease business or go bankrupt, but the TRN is not re-used and always remains with the same enterprise name. The SSIGO also needs to know this information about ceased businesses so that they can cancel the inactive employers from their system.

The following table shows a comparison between the number of employers registered with the SSIGO and the number of enterprises registered with the Tax Department for Ulaanbaatar City districts. The SSIGO data is at September 30, 1999 and the Tax Department data is at January 1, 1999. There are other reasons why the numbers would not exactly agree, but you would expect them to be similar. However, the differences are quite significant in all but the smallest offices.

¹ The International Standard Industrial Classification (ISIC) code is a 4 digit coding system to classify businesses by type of activity. The Tax Dept. assigns up to 3 ISIC code numbers to each business based on the description of intended business activities provided by the business at the time of registration. The National Statistical Office also uses the ISIC code system to collect trade statistics.

District	Tax Department			SSIGO
	Enterprises (excluding self employed)	Central Budget organizations	Other Government organizations	Employers
Sukhbaatar	1826	17	335	1023
Chingeltei	1246	499	192	1538
Bayanzurh	1367	215	290	695
Bayangol	1736	40	212	1099
Haan-uul	481	261	112	674
Songino- khairkhan	875	48	106	584
Nalaih	173	17	31	177
Baganuur	134	25	54	137
Bagahangai	(Data not available – probably included in above numbers)			26

Recommendations

- All enterprises registered with the business registration unit in the Tax Department should be automatically registered with the SSIGO as employers.
- The Tax Department should send an updated registration database to SSIGO computer center on a weekly basis.
- The SSIGO registration database should be amended to include a field for the Taxpayer register Number, and eventually this number should replace the Certificate Number as the primary identifier.
- The SSIGO should record in their database the business activity (ISIC) codes and other data provided by employers at the time of registration with the Tax Dept.
- Self employed individuals who make voluntary contributions for themselves should use their Citizens Register Number as the primary identifier.
- Self employed individuals who have employees should be registered with both the Tax Dept. and SSIGO as employers who are required to withhold personal income tax and pay social insurance contributions on their employees' wages.

The system of registration of enterprises for taxation and social insurance purposes could work a lot better than this if some fairly simple improvements were introduced. The concerns with the present system are:

- It is extra work and inconvenience for enterprises to have to register twice and have two different numbers.
- There is no guarantee that all employers registered with the Tax Department are also registered with the SSIGO.

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- There is no easy way to check which employers might be missing from the SSIGO registration database.
 - The SSIGO does not have easy access to the data kept by the Tax Department because they are using different numbering systems.

Enterprises should only need to be registered once, and should only need one registration number, to cover both taxation and social insurance obligations. When an enterprise applies for registration with the Tax Department, they should be automatically registered as Social Insurance Payers (employers). The application form for registration as an enterprise (company, cooperative or partnership) should be amended to ask the enterprise how many employees (including company directors and partners) they intend to have in the first year of operation.

Every week, the Tax Department should send an updated copy of the business registration database to the SSIGO computer center (in future, this should be an online connection). The Tax Department's database is presently a Clipper application like the SSIGO's database, so technically this is not difficult. The computer center should use this data to update the SSIGO registration database with the new employers, and produce control lists of ceased business cases for cancellation action. The other data in the business registration database (addresses, names of directors, bank accounts, ISIC codes, etc.) should also be linked to the SSIGO database and made available on computers in district and Aimag offices.

After registration with the Tax Department, the enterprise should begin filing social insurance declaration forms with the SSIGO. By the time the first month's forms are due, the enterprise will already be registered in the SSIGO's registration database. It is not necessary to get the employer to fill in an application form, because registration as an employer is automatic and there are no decisions to be made.

Regarding the different registration numbers, the SSIGO computer center should modify the registration database to include an extra field for the TRN. This will enable comparison of data between the two databases, which will be of considerable benefit to the SSIGO. At a convenient time in the future, the SSIGO should stop using the Certificate Number as their primary identifier and switch over to the Taxpayer Register Number.

PROCESSING OF CONTRIBUTION FORMS AND PAYMENTS

Diagram A (located in Appendix A) shows the main procedures for processing declarations and payments. At the end of each month, every employer should complete two declaration forms and deliver them to their local SSIGO office by the fifth day of the following month. The employer or payer declaration form (Form No. 7) shows the number of employees, the total salary paid and the total contributions payable for all employees. The total contributions payable is the amount of debit (DR) posted to each employer's account with the SSIGO. The form also shows the amount of benefits paid out by the employer, and the amount paid to the social insurance fund. It also shows a breakup of the total contributions into the amounts paid for each fund (pension, benefits, unemployment, workers compensation, and health insurance), and a further breakup into employer and employee contributions for each fund.

The second form is the contributor declaration form (Form No. 8). This form lists each employee (contributor) by name and citizens register number. It shows each employee's salary and the amount of contributions payable on that salary. The information on this form is used to update each contributor's individual account. The rate of contributions can vary between employees because there are different rates of contributions payable for workers compensation insurance (1%, 2%, or 3%), depending on the nature of work conditions. This form also breaks up the contributions by employer and employee contributions for each type of fund. However, only the salary and total contributions for each employee is input by the inspector, and the system automatically makes the allocation between the different funds. The total contributions payable for the current month in Form 7 and Form 8 should be equal.

By the fifth day of each month, the employer should go to a bank and make a payment equal to the total contributions payable, usually by bank transfer, to special bank accounts nominated by the SSIGO. (Chingeltei office, for example, has correspondent accounts with five banks). Each bank advises the SSIGO how much money was paid into these accounts on a daily basis, and sends copies of the bank transfer or payment forms to the local SSIGO office so that they know how much each payer has paid. The SSIGO account enters these payments into the computer system, and these form the credits (CR) on each employer's account. The bank payment forms show the payer's name and bank account details, but not the payer's social insurance Certificate Number or TRN.

Every employee also has a salary book, issued by their first employer. The employer enters the monthly salary and contribution details for each employee into their salary book. Each month the employer takes all the salary books for all employees to the SSIGO office, where the contribution inspector checks that the entries in the salary book agree with the details shown in the contributor declaration form (Form 8).

It is important to note that the contribution details shown in the contributor declaration forms and the salary books are the social insurance contributions payable – not the contributions actually paid. When the inspector checks the salary books, she also checks whether the employer is up-to-date with the payments. If the employer is in arrears, the inspector makes an estimate or calculation of which month the employer has paid up to. This information comes from an analysis of the employer's account (the difference between the debits and the credits in the computerized accounting system). The inspector puts a stamp in each salary book next to the paid-up months, and the entries for the months where no payment has been received are not stamped. If all entries have not been stamped, the employee may not be entitled to pensions and benefits.

Therefore, each contributor's individual account with the SSIGO contains a record of the contributions payable, whether or not the employer has made all the payments. Where contributions have not been paid in full, this is a debt owing to the pension fund by the employer – not a debt owing by each individual contributor. In my view, this is the correct approach. Article 16 of the Law on Social Insurance requires employers to deduct contributions from employees' wages and pay the money to the pension fund.

While Article 17 suggests that both employers and employees are both liable to account for contributions and make payments on time, in practice only the employer is required to do these things. This is clear from Article 20, where penalties for non-compliance with the law including failure to pay contributions on time only apply to employers, and not to employees. If further clarification is needed that the employer is liable for the debts, Article 6 (2) says that insured persons

shall not be disqualified from receiving a pension or benefit because the employer has not paid the contributions.

Recommendations

The objective should be to achieve a highly efficient processing system that accurately collects only essential information at minimum costs to employers and the SSIGO.

- The employer declaration forms (Form 7) and the contributor declaration forms (Form 8) are out of date and should be redesigned to simplify the forms and to remove the requirement to split the contributions up between different funds.
- When the SSIGO establishes an Internet web site, employers should be able to download these forms for free from the web site.
- SSIGO should encourage employers with more than 100 employees to file contribution declaration forms by diskette using a standard spreadsheet format.
- SSIGO should request employers to put their Certificate Number and Taxpayer Registration Number on all bank payment forms so that payments can be easily recorded against the correct accounts.
- The information in the salary books of current contributions is now a duplication of the information already recorded in the SSIGO's computer system. Within the next 12 months, after the first annual contribution statements are sent to all contributors, it should be possible to phase out the salary books, thereby eliminating a major workload for both employers and the SSIGO.

PRIMARY CONTROL SYSTEMS

Diagram B (located in Appendix B) shows the primary control systems that are in place in the SSIGO's computer system. The first test (top right-hand corner of the diagram), is to check that each employer has filed declarations for every month. This is obvious from looking at each employer's account in the system, because the missing months are blank. When the employer comes to the SSIGO office to file his monthly declarations, the inspector checks the account on the computer, and if there are any blank months, she asks the employer to file the missing declarations. However, if the employer does not come to the office for some months, there is a risk that no-one looks at his account and chases him for the missing declarations. This part of the control system relies on inspectors manually checking every account each month, and taking action to collect the missing declarations. With increasing work volumes, this manual control mechanism is likely to break down.

The other primary control features are shown at the bottom of Diagram B. As described above, each SSIGO office has one or more pension fund bank accounts where employers and voluntary payers transfer their contribution payments. Each day, the office accountant has to reconcile the total money banked in the Pension Fund's bank account with the total payments credited to employers' accounts. If there is a difference, the accountant identifies the error and corrects it.

Each payer (employer or voluntary contributor) has an account in the SSIGO's accounting system. Where the total debits from the payer declaration forms exceeds the total credits from the payment forms, the balance of the account is a debit and the payer has a debt to the SSIGO. In practice, some employers make their contribution payments at the same time as the wages are paid, which can be before the end of the month and before the declaration forms are filed. In these cases, the balance of these employers' accounts can be in credit at the end of the month.

Management reports are produced at the end of each month to show lists of employers by type of enterprise, the debit or credit balances, and details of the last payment. The computer can also produce a list of the largest 30 debtors. These reports are used as the basis for debt collection activities.

The computer system also compares the total amount on the payer declaration (Form 7) with the total on the contributor declaration (Form 8) to check the calculations and make sure that the totals agree. Where there are differences, the inspector has to contact the employer and correct the errors.

Recommendations

- The system identifies missing monthly declarations, but a non-filer action report should be produced to list all employers with missing declarations, ranked in order by how many declaration forms are outstanding. This report should be produced in the middle of each month – about 14 days after the declarations are due to be filed.
- Bank deposits to pension fund accounts are reconciled with payments credited to employers SSIGO accounts, but usually the same person who inputs the payments also does the bank reconciliation. This is an internal control weakness, and the reconciliation process should be regularly checked by the SSIGO office manager or by internal auditors from SSIGO headquarters.

DEBT COLLECTION

The total debts due to the Social Insurance Fund at the beginning of October 1999 were 11.7 billion tg. This is 28% of planned collections for 1999 (42.2 billion tg.) and about 1.1% of 1998 GDP (\$US1.04 billion). By way of comparison, the total tax debts owed to Tax Department at mid November 1999 were 31.5 billion tg.

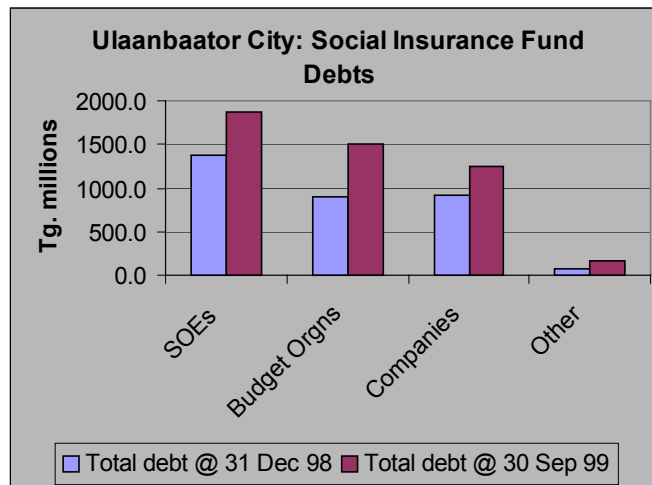
The total debt has increased by 30% in the nine months since January 1, 1999, and the following table shows that in some offices the increase has been in excess of 200%. However, some of the smaller offices depend heavily on a few big employers, and if these employers stop paying, the debt can increase dramatically.

Mongolia: Social Insurance Fund debts
(Tg. Millions)

Office	Debts at 1.1.99	Debts at 1.10.99	Increase in debts to 1.10.99	Percentage increase
Arhangai	25.8	80.1	54.3	210%

Bayan-olgi	135.7	228.8	93.1	69%
Bayanhongor	153.9	206.9	53.0	34%
Bulgan	150.5	177.8	27.3	18%
Gov-altai	42.6	70.3	27.7	65%
Dornogov	217.5	151.8	-65.7	-30%
Dornot	340.5	352.0	11.5	3%
Dundgov	10.0	39.7	29.7	297%
Zavhan	87.2	116.3	29.1	33%
Ovorhangai	37.4	80.0	42.6	114%
Omnogov	43.7	66.1	22.4	51%
Sukhbaatar	106.5	158.3	51.8	49%
Selenge	1041.9	1266.0	224.1	22%
Tov	642.2	766.3	124.1	19%
Uvs	118.7	86.9	-31.8	-27%
Hovd	69.6	195.5	125.9	181%
Hovsgol	153.7	319.4	165.7	108%
Hentai	323.9	526.1	202.2	62%
Darhan-uul	1014.8	1603.4	588.6	58%
Orhon	783.8	832.3	48.5	6%
Govsoomber	211.9	224.0	12.1	6%
Ulaanbaatar	3271.0	4147.4	876.4	27%
Total	8982.8	11695.4	2712.6	30%

A closer analysis of the debt in Ulaanbaatar City offices shows that 39% of the debt in these offices at October 1, 1999 was owed by State Owned Enterprises (SOE), and a further 31% was owed by budget organizations. The debts owed by budget organizations have increased by 68% since the start of the year, and are of particular concern. Apparently, most of these debts are owed by the City Government budget organizations, and these debts are expected to be settled by the end of 1999. However, non-payment of social insurance contributions by budget organizations – whether it is central or local Government – sets a bad example, and jeopardizes the financial viability of the pension scheme.



The debt problem is widespread in Mongolia at present, and the pension fund revenue is suffering from the impact of a whole raft of other events that are not within their control. The Government has a cash flow problem and is unable to pay salaries for some employees. There are serious problems in the banking sector, with several of the main banks close to insolvent. As a result of dubious lending practices, the banks have a large number of unsecured, non-performing loans. There are stories that some of the banks are holding on to money paid by their customers for taxes and pension contributions, and not passing this money on to the Government on time. Problems with the banking system in the Aimags, particularly with the Agriculture Bank, have meant that pensioners are not receiving their pensions and benefits on time. And there are the usual concerns that the Government may not always be spending revenue wisely – a notion which is helped along by frequent changes of Government and an impending election.

All these factors come together to produce an unhealthy attitude towards paying debts, and paying tax and pension fund debts in particular. Rather than being discouraged by this, the SSIGO should accept that the prevailing situation means that they have to work harder to collect their debts.

Generally, the District and Aimag offices are responsible for debt collection. The SSIGO headquarters collects statistics about the debts for the whole country, and their audit unit helps in debt collection, but they usually take no role in managing the debt collection process. Each District office has about six contribution inspectors and two control inspectors, with 20-25 staff in total. The number of inspectors in the Aimag offices is less than this – Tov Aimag for example has four contribution inspectors. Each Soum office usually has one inspector, who is responsible for both collecting contributions and determining entitlements to pensions and benefits.

The contribution inspectors have primary responsibility for debt collection. Each contribution inspector has their own range of employers, from whom they collect and process declarations. When an employer has missed filing declarations for any month, or has failed to pay the full amount of contributions, it is the contribution inspector's job to contact the employer and ask for the declarations and payment. This contact can happen when the employer comes to the SSIGO office to file monthly declarations, or the inspector can go to visit the employer. The control inspectors, who normally do audit work, also try to collect debts from employers, as do the Soum inspectors.

Each office can get a list of all debtors from the computer system, or just a list of the largest debtors. For new debts, the inspector interviews the employer and tries to obtain payment in full or an offer to pay by installments. Approval to repay a debt by installments is given only for a maximum of three months, and the approval is subject to payment of current contributions on time. The inspector takes into account the financial position of the employer, and whether any previous installment arrangements were met. A penalty interest of 0.3% per day is applied in all cases where contributions are not paid on time.

The SSIGO has limited rights to take enforcement action to collect debts in the more difficult cases. Article 25 of the Social Insurance Law allows the SSIGO:

- (2) To temporarily suspend the expenditure transactions of an employer's bank account where the employer has failed to pay contributions on time, until the contributions are paid;

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- (3) To recover, in compliance with the relevant provision of legislation, the amount equal to contributions arrears, fines, interest and penalties not paid in due time as indicated in the account presented by a social insurance inspector;
 - (5) To enforce liability, as prescribed in the Law, for an employer who avoids payment of contributions, arrears, interest and penalties and fails to provide contributions report in time and undertake measures to extinguish offenses detected in the course of the social insurance organization's inspection."

The SSIGO has no rights to demand banks to transfer funds from an employer's bank account to the pension fund, and no rights to seize and sell assets. Ordering the bank to stop expenditure transactions was seen to be the easiest enforcement method, but this approach is of limited usefulness, as employers can just change to another bank when an order is imposed. The method normally used is to give the case to the District Prosecutor's office, who tries to get the Court to make an order to repay the debt. When the Court issues such an order, officers from the Court Decision Enforcement Unit take over enforcing the debt. These officers visit employers, inspect their records, and can seize the employer's money and assets if they do not agree to repay the debt.

The SSIGO also gives reports about their debts to the Governor's office, and the debts are discussed at the Council meetings and in Citizen's Representative Committees. In Ulaanbaatar, there are regular meetings with the City Governor's office every two weeks to discuss actions to collect social insurance fund debts. Recently the SSIGO introduced a competition to reward court decision enforcement officers who collected the most debts, and between July and October these officers collected about 500 million tgs.

There is also a Bankruptcy Law that applies to enterprises and individuals who are unable to pay their debts. In the event of bankruptcy, the Bankruptcy Law gives first preference to payment of employees' salaries, and second preference is equally shared between tax debts and social insurance fund debts. (It was not clear to me if the Court process referred to above was part of the bankruptcy process or a different legal process). While seizing and selling assets can be effective in recovering debts, the advantage of bankruptcy proceedings is that it permanently solves the problem by closing the defaulting enterprise down and preventing it from incurring more debts.

In contrast to the SSIGO, the Tax Department has stronger legal powers of enforcement. Articles 22 to 25 of the Law "On Supervision of Tax Levy, Payment and Collection" provide the Tax Department with powers to collect tax debts from a debtor's bank account or from salary income, property income, or other income being paid to the debtor. Article 26 allows the Tax Department to seize and sell a debtor's assets, and Article 27 describes procedures for taking a debtor to Court. Article 37 and 38 give the tax inspectors a right to seal a taxpayer's property to prevent the taxpayer disposing of his assets when there is a debt or during an audit.

Recommendations

- Debt collection units should be established to deal with debts older than one month.
- Initial collection action should be taken by telephone and written demands.

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- SSIGO needs the same legal powers as tax inspectors (see Law on Supervision of Tax Levy, Payment and Tax Collection).
 - There should be a joint committee with Tax Dept before taking Court action.
 - The Social Insurance Fund should receive preference over other tax debts for payments by debtors.

The present situation with debt collection in district and Aimag offices seems to be that it is everyone's job – but nobody's responsibility. There is enough important debt collection work to do in every office to justify establishing debt collection units in each office, and making it a full time job for one or two people. Dedicated debt collection officers would be more effective in putting pressure on employers to pay than contribution inspectors who see the employer every month.

To complement these units, a small debt collection management unit should be created in SSIGO headquarters to develop new procedures, initiate changes to laws and regulations, make high level representations about debts owed by budget organizations and state-owned enterprises, and to monitor debt collection performance across the country.

Diagram C (located in Appendix C) is a flowchart showing the steps that should be taken to collect debts. It is important to take quick action to try to collect new debts while the enterprise is still in business and has some money. Much greater use should be made of telephones and letters to contact debtors and demand payment, as these methods are more efficient than personal visits and can be just as effective.

Debt collection is a competitive business. When an enterprise starts having cash flow problems, there are competing demands from creditors for the limited cash available. If the enterprise finds it is having trouble paying salaries, electricity, heating and phone bills, suppliers' invoices, taxes and pension contributions, they will pay those creditors who are pressing the hardest for payment, and try to defer payment of other debts in the hope that their financial situation will improve.

While there is a general belief most employers want to pay their pension contributions because they realize this will benefit their employees, there will always be a sizeable proportion of employers who will not care about this high moral ground. Therefore, the SSIGO needs to have stronger powers such that it is on equal terms with other creditors. In particular, the SSIGO should have equal rights as the Tax Department to seize money and assets without taking Court action.

The SSIGO should cooperate with the Tax Department at the regional level to collect debts. There should be regular monthly committee meetings where the two Departments exchange information about their larger debtors and agree on a common approach before taking action to sell assets to go to Court.

The SSIGO should reach agreement with the Tax Department to receive a preference for payment of pension fund debts ahead of other tax debts in the case of seizure of assets and bankruptcy. Perhaps this preference could be limited to the debt accrued in the last 12 months before bankruptcy, to avoid problems with those cases where there are large debts that are many years old (in one office, 70% of the debt was more than 12 months old).

AUDIT ACTIVITIES

Similarly to the debt collection function, the SSIGO audit function is mainly located in district and Aimag offices. There are usually two auditors (control inspectors) in each district office, but in the Aimag offices the contribution inspectors are also the auditors, because of the low numbers of staff. At the start of 1999, a new unit of 8 auditors was established in SSIGO headquarters. This unit has national responsibility for the audit function. They also do their own audits of large enterprises, and carry out an internal audit type function to check that other SSIGO offices are following correct procedures, determining benefits correctly, and conducting audits properly. In 1999, the headquarters unit inspected each district office and conducted 100 audits of employers.

Estimates of the level of non-compliance are always difficult to find without considerable effort. However, it is worth attempting to derive estimates from national statistics and other data to try to find an indication of the extent of the problem.

For example, based on data for contributions paid by Ulaanbaatar City employers from January to September 1999:

Average monthly salary per contributor per salary fund	24,500
Estimated contributions at 29% of average salary	7,105
But average gross monthly salary for UB City estimated by the National Statistical Office (mid 1999)	31,700
Estimated contributions at 29% of average salary	9,193
But average contributions paid per contributor per month	<u>7,400</u>
Difference	1,793
Potential revenue per month (1793 * 237842 contributors)	426 million

(Source: Ulaanbaatar City SSIGO financial reports, 3rd quarter 1999; National Statistical Office "Statistical Bulletin 1999/9")

The social insurance collection system is based on self-assessment by employers, and voluntary contributions by employees. This means that employers are responsible for calculating both employer and employee contributions based on wages paid, and forwarding the calculated amount to the social insurance office. Employers who do not voluntarily file their declarations and pay the contributions due:

- Undermine the self assessment system and the pension scheme;
- Jeopardize employees entitlement to pensions and benefits; and
- Create unfair competition between those who pay their contributions and those who don't.

A description of the SSIGO's present method of conducting audits starts with an annual exercise to determine the size of each employer's salary budget for the following year. Each employer submits the salary budget to the SSIGO and the Tax Department. The inspectors from both Departments interview the employer and try to verify that the salary budget estimate is correct. In the case of budget organizations and State owned enterprises, the salary fund estimate is sent to the Ministry of Finance, where the estimate is again verified and often altered. This is a central planning mechanism that takes up a lot of resources and is of doubtful value.

During an audit, the SSIGO auditor checks if the salary paid agrees with the estimated salary fund. The auditor looks at the financial documents and reconciles the amounts of salary paid with the contribution records, and she also looks at the cash account and bank account for evidence of salary payments. The auditor examines the labor contracts to determine if the salary and benefits shown in the contracts agree with the amounts of salary paid. They also compare the salary paid with the salary declared for tax purposes.

One of the main areas of underpayment of contributions comes from the definition of insurable earnings. For social insurance purposes, “insurable earnings” are defined as being gross wages plus fringe benefits, but for personal income tax purposes, fringe benefits are excluded from the definition of “taxable income”. The different definitions are unfortunate, because it causes confusion for employers, and there are subsequently underpayments of social insurance contributions.

A second area of non-compliance comes from a lack of a proper definition in the Social Insurance Law for “employee”. There are an increasing number of cases detected where persons are doing work for enterprises and saying that they are self-employed contractors, but the inspectors consider that they are employees. There needs to be some guidelines to distinguish between the two classes of workers. Some suggested guidelines are in Appendix D.

The Ulaanbaatar City office produces an annual audit plan for the city districts, and each Aimag office produces their own plan. There is a target to audit all enterprises every two years, but this is becoming increasingly difficult to achieve. Factors taken into account in selecting cases for audit include whether the enterprise has large debts, and how long since the previous audit was done. There was no indication that the problem areas mentioned above were considered as possible factors when selecting cases.

The Tax Department’s audit division takes a number of factors into account in selecting cases for auditing, and rates each factor with a scoring system to give an overall risk factor rating for each business taxpayer. The factors they take into account include:

- The size of the tax payments,
- Whether the taxpayer has a good or bad relationship with the Tax Department,
- The type of business activity,
- The standard of the taxpayer’s accounting system,
- The length of time since the last audit, and
- The results of the last audit.

The Law on Social Insurance provides penalties for understating of contributions, and these penalties appear to be adequate. Article 26 specifies the rights of auditors to collect information and inspect documents, but these powers need to be wider similar to those included in the Law “On Supervision of Tax Levy, Payment and Collection”.

Recommendations

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- Employers should be audited by specialist inspectors. Audit work requires specialist staff. This should not be done in conjunction with other work.
 - Improved selection criteria should be used for choosing audit cases.
 - Auditors need access to external information - particularly Tax Dept information - to assist in identifying risk and selecting cases with high revenue potential.
 - Different types of audit should be used to increase efficiency.
 - An annual audit plan should be prepared with targets expressed in case numbers.
 - Measure audit performance.
 - Measure whether annual plan was achieved.
 - Compare amount of audit revenue and penalties over total revenue collected in previous year, by office.
 - Compare audit revenue calculated with audit revenue actually collected.
 - Assess the number of cases per auditor and the quality of work done.

COOPERATION WITH THE TAX DEPARTMENT

A number of examples have been given above where improved cooperation with the Tax Department would benefit the SSIGO. The work of the two organizations is closely related. Both organizations are trying to collect revenue from the same group of employers from the same revenue base (personal income). Therefore, it is important to try to coordinate activities to minimize inconvenience to employers, to share information, and to improve compliance. The SSIGO also needs access to information from the Tax Department when determining eligibility for payment of pensions and benefits.

Recommendations

The following summarizes some of the areas where improved cooperation would be beneficial:

- Tax Department can provide SSIGO with regular updates of the business taxpayer registration database.
- Monthly meetings should be held between Tax Department and SSIGO managers in each district and Aimag to discuss debt collection issues.
- Exchange of information about the largest debtors.
- Tax Department to help SSIGO find missing employers.

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- SSIGO to give Tax Department salary data on annual basis to check against corporate income tax returns.
 - Tax Department to audit social insurance contributions when conducting audits, and advise SSIGO of results.

It would be appropriate for the SSIGO and the Tax Department to prepare a cooperation agreement to incorporate the above issues. It may also be necessary to make changes in the laws to allow the two Departments to exchange information.

APPENDIX A: MAIN PROCEDURES FOR PROCESSING DECLARATIONS AND
PAYMENTS

APPENDIX B: PRIMARY CONTROL SYSTEMS

APPENDIX C: DEBT COLLECTIONS PROCESS

APPENDIX D: EMPLOYEE OR SELF-EMPLOYED CONTRACTOR?

Introduction

An employee is a person who works for an enterprise or another person under a labor hire agreement, or under a written contract or agreement that is only for the supply of the individual's labor. Registered companies are not employees, but company directors are employees of their own companies. A registered partnership is not an employee, but one or more of the partners can be an employee if they supply labor to an enterprise or another person.

Where a written contract does not exist, the following guidelines should be used to determine if an individual is an employee or a self-employed contractor. (NB. A person can be registered with the Tax Dept. as a self-employed individual and still work as an employee for an enterprise or another person.

An employee is an individual with certain rights, obligations and legal liabilities associated with the work he/she undertakes. These rights, obligations and liabilities differ from those applying to a self-employed contractor.

A key factor in deciding if a worker is an employee is the degree of control capable of being exercised over the worker. If the payer has the right to direct how, when, where and who is to perform the work, it is likely that the worker is an employee. These directions may or may not be in writing. If there is a written contract or agreement, the terms of the contract should be studied to determine whether the person is an employee or not, taking into consideration the following guidelines.

Employee

Indicators that a worker is an employee may include that the worker:

- Is paid for the time worked;
- Receives (or is entitled to) paid leave (e.g. holiday, sick, recreation, long service);
- Is not responsible for providing materials or equipment required to do his job;
- Must perform the duties of his/her position when and where the payer directs;
- Agrees to provide his personal services (he cannot hire someone else to do his job);
- Works to hours set by an agreement or award;
- Takes no commercial risks and cannot make a profit or loss from the work performed.

Contractor

An independent contractor is an entity (e.g. an individual, partnership, trust, or company) that agrees to produce a designated result for an agreed price. In most cases, the contractor:

- Is paid for results achieved rather than days worked;
- Provides all or most of the materials and equipment necessary to complete the work;
- Is free to hire his own employees or subcontract work to other entities;
- Has freedom in the way the work is done;
- Can decide where and when the work is done;
- Provides services to the general public and other businesses;
- Is free to accept or refuse work;
- Is able to make a profit or incur a loss from the work.

	Employee	Contractor
Control over work	Skilled employees may have a high level of independence in the way they work, although the framework within which they work would be set with or by the employer.	Typically, a contractor has a higher level of independence in the way the work is performed, within the limits of the contract for the work.
Independence	Employees have a duty to perform work for the employer as directed or in accordance with an employment contract.	The contractor must perform duties in accordance with the contract, but not necessarily in other roles except by agreement.
Payment	Often based on the period of time worked, but can also be paid by the number of items produced, or by commission.	Typically payment is according to results without regard to the time taken.
Legal liabilities	The employer, not the employee is legally liable for the work.	The contractor is legally liable for the work performed under the contract.
Commercial risks	The employee generally bears no risks in respect of the work and is not liable to remedy any defective work at their own expenses	The contractor bears the risks and has the potential to make a profit or loss. The contractor is responsible to remedy any defective work at his own expense.
Integration in business	The employee works as an integral part of the employer's business.	The contractor works as part of his own business and may be associated with the operations of another business.
Ability to delegate	The employee performs the work personally and cannot delegate the	A contractor has the ability to delegate the work by agreement or otherwise.

	work.	
Tools and Equipment	Ordinarily provided by the employer, except when specifically agreed otherwise.	The contractor provides their own tools and equipment.

APPENDIX E: COLLECTION ENFORCEMENT

The following presentation was delivered to a group of 30 officials from the State Social Insurance Office on 18 November 1999.

Main processes of debt collection

- Identify and prioritize the debt
- Initial contact with the debtor
- Offers to pay and installment arrangements
- Enforcement methods - seizing money and assets
- Legal collection procedures
- Business restructuring or bankruptcy
- Bad and doubtful debts
- Debt management

Identify the debt

- Self assessment by employers
- Specific due date for payment
- Correct identification of the debtor (employer)
- Computerized accounting system to identify account balance
- Automatic calculation of interest

Categorize the debt

- Not due for payment yet
- Collectible debts
- Installment arrangement approved
- Employer has vanished
- Disputed debt
- Legal action in course

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- Employer is bankrupt
 - Doubtful and bad debts

Debt collection priorities

- New debts are easier to collect
- Big debts are most cost effective to collect
- Old debts are harder to collect
- Small debts are the least cost effective to collect

Initial contact

- Telephone
- Computerized payment demands
- Standard letters
- E-mail
- Information needed:
 - Employer's name, address, phone number, e-mail address
 - Information about the debt

Computerized payment demands

- Computer identifies new debts
- Demand notices produced and posted to employers 7 - 14 days after due date
- If not paid, computer identifies case for debt collection action. (Need updated address database, reliable postal system)

Installment arrangements

- Analyze financial position and previous payment history
- How much does employer owe to Tax Dept.?
- Maximum arrangement for 6 months, with regular monthly payments
- Future monthly contributions must be paid on time
- Subject to penalty interest (0.3% per day)

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- Confirmation letter to employer
 - Computer should monitor installment payments
 - Training in negotiation and financial analysis

Enforcement - confiscating money

- Employer's bank account
- Available cash
- Money owed to employer by his customers, by the Government, by other persons

Enforcement - confiscating assets

- Visit to employer - need to consider cost-effectiveness
- Ask for payment or offer to pay
- Identify and list available assets (get information from Income tax return?)
- Physical seizure or notional seizure
- Sale of assets by auction

Legal collection procedures

- If employer refuses to pay the debt, SSIGO can apply for a Court order to collect the debt
- SSIGO should consult with Tax Dept. before going to Court
- Court makes an order to enforce the debts
- Court Decision Enforcement Officer appointed
- Assets confiscated and sold by Court Order

Business restructuring or Bankruptcy

- Creditors meeting to decide if business should continue or be made bankrupt
- Court formally approves creditors' decision and appoints administrator or liquidator
- SSIGO may have to agree to write off some of the debt as part of arrangement
- Special situation for privatization of State enterprises
- Needs specialist lawyers and negotiators

Bad and doubtful debts

- Tracing actions for missing employers
- Prepare schedules of debts for writing off
- Write off old debts, and debts that are uneconomical to collect
- Debts are written off the books - but not forgotten

Debt collection management

- Need for current account and accurate, timely information
- Creation of case files
- Case management system
- Debt collection targets and performance measurement

Exercise: Reasons for non-payment

- I didn't know about the debt
- I forgot about the debt
- I lost the invoice or payment form
- I didn't know where or how to pay it
- It's someone else's job to pay it
- I paid it yesterday (the check is in the mail)
- The Bank has closed my account
- The Tax Dept has closed my account
- I had to pay the Electricity company
- I'm waiting for a customer to pay
- The Government owes me money

APPENDIX F: AUDITING EMPLOYERS FOR SOCIAL INSURANCE CONTRIBUTION PAYMENTS

The following presentation was delivered to a group of 20 auditors and audit managers from the Social Insurance Department on 24 November 1999

The audit function

Auditing is a comparison of the employer's bookkeeping records with his declarations, taking into account:

- wage-related information (e.g. labor contracts)
- banking information (e.g. wages paid)
- external information (e.g. from Tax Dept.)
- business activity trends
- physical observations

Main steps in the audit process

- Selection of audit cases
- Annual audit plan
- Commencing the audit
- Conducting the audit
- Finalizing the audit
- Case management system
- Evaluating the results
- Measuring audit performance

Selection of audit cases: Indicators of underpayment from employer declarations

- Below average wages paid per employee for this type of business
- Excessive hiring and firing of employees
- Average business revenue per employee is rising over time

Selection of audit cases: Indicators of risk from type of business activity

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- Frequent replacement of employees and many part-time employees
 - Large cash sales, and wages paid from available cash
 - General reputation as dishonest businessmen
 - Complex employer-employee relationships
 - Poor bookkeeping or knowledge about the law

Selection of audit cases: Enterprise-based risk indicators

- Size of the business
- Type of ownership
- Result of previous audit
- Time expired since last audit
- Result of previous audit by Tax Dept.
- Poor history of filing declarations on time
- Social insurance fund debt and other tax debts

Annual audit plan

- Identify which types of employers have greatest risk, and develop strategies to deal with each category (in cooperation with Tax Dept)
- National plan to carry out these strategies
- Specifies how many cases should be done, what type of cases, and how much time should be allocated to audit work
- Office-based plans support the national plan, and specify which employers will be audited

Commencing the audit

- Manager gives written direction to auditor, specifying reasons why this case has been selected
- Maximum two auditors per case - allocate 2 to 4 weeks work at a time
- Auditors examine files and analyze available information
- Contact employer and arrange appointment

Conducting the audit

- Different types of audits
- record-keeping audit for new businesses
- audit of a specific month or employee
- comprehensive audit covering a certain period
- Conduct a head count of workers. Ask a sample of workers for identification.
- Compare sign-in book with wages records
- Look for large cash withdrawals from bank around payday
- Use estimating methods to save time

Finalizing the audit

- Interview with employer to discuss conclusions
- Simple method is needed to get employer's written agreement (e.g. amended declaration form).
- Also need to adjust employee contribution records
- Reduced penalty for cooperation during audit and agreement with audit result
- Ask employer for payment or a payment proposal
- Standard audit report also serves as a check list

Case management system

- Keeps track of audit cases in progress and completed
- Able to match auditors with their audit cases
- Records time spent on each case, additional revenue found, penalties calculated, revenue collected

Evaluating the results

- Update employer's risk profile - will this employer cause problems in the future?
- Compile statistics about audit work done
- Was there any indication that this employer was underpaying taxes?

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- Did this case indicate non-compliance by other employers?

Audit performance measurement

- Number of cases completed
- Additional revenue and penalties calculated
- Additional revenue and penalties actually collected (paid)
- Quality of auditor's work (were all the audit checks correctly done, were all the problems resolved?)